FOOTHILLS

Oil & Gas Ltd.

ANNUAL REPORT

DECEMBER 31, 1997

CORPORATE PROFILE

Foothills Oil & Gas Ltd. is a Calgary based, public oil and gas company. It is engaged in the production, acquisition and development of hydrocarbons in Canada. Management is currently pursuing growth through the acquisition of producing properties where it has identified future upside potential. The common shares of the Company are listed for trading on The Alberta Stock Exchange under the symbol "FH".

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ANNUAL GENERAL MEETING

Shareholders and members of the public who are interested in receiving more information are invited to attend the Company's Annual Meeting to be held at the offices of Macleod Dixon, 3700, 400 - 3rd Avenue S.W., Calgary, Alberta at 3:00 p.m. on Wednesday, June 24, 1998.

HIGHLIGHTS

		December 31, 1997		December 31, 1996
Production				
Oil and natural gas liquids (barrels per day)		38		26
Sales price (per barrel)		$ 20.71		$ 24.64
Natural gas (thousand cubic feet per day)		54		89
Sales price (per thousand cubic feet)		$ 1.70		$ 1.43
Barrels of oil equivalent per day		43		35
Reserves (barrels of oil equivalent)		217,193		160,457
Financial				
Revenue (before royalties)	$	320,992	$	141,712
Cash flow from operations before changes in working capital	$	21,222	$	23,748
per common share (basic)	$	0.00	$	0.00
Net earnings (loss)	$	(408,525)	$	(16,932)
per common share (basic)	$	(0.04)	$	(0.00)
Capital expenditures	$	879,828	$	63,550
Working capital	$	7,021	$	178,027
Common shares outstanding (year-end)		11,715,000		9,420,000
Common shares outstanding (weighted average)		10,042,671		9,420,000

Report to Shareholders

This Annual Report covers the twelve month period from January 1, 1997 to December 31, 1997.

During 1997, the Company continued to position itself for future growth through its strategy of acquisition of producing properties. During the year, two separate acquisitions were completed in the Clive Area of central Alberta. These transactions added production of approximately 25 barrels of oil equivalent per day resulting in fourth quarter production of 52 barrels of oil equivalent per day.

In light of the depressed commodity prices at year end, the Company has recorded a writedown in its book value at year end of $310,000. Although the Company was not required to take this step, the Board believes it an appropriate and conservative approach.

In conjunction with these acquisitions, the Company completed a $500,000 private placement during September, 1997 with the issuance of 2,000,000 common shares at $0.25 per share. Of this total, 962,500 common shares were issued on a flow-through basis.

The addition of Mr. Wayne Fast, PEng as Vice President in November, 1997 is an important step by the Company to fully meet its growth strategies. Mr. Fast has over 27 years of oil and gas experience.

As stated in previous reports, Management is pursuing a strategy of growth through carefully planned and evaluated acquisitions with emphasis on quality proved producing properties. To this end, Management has turned it attention to the evaluation of several larger asset opportunities and is currently conducting the necessary due diligence on these projects.

The Company is pleased to announce the addition of Ms. Susan McArthur to the position of Director subsequent to year end. Ms. McArthur brings over 12 years of international and domestic investment banking experience to the Board and her advice and counsel will be greatly appreciated.

Management, directors and staff look to the upcoming year with enthusiasm.

William J. Kiff
President

OPERATIONS

During the past twelve month period, the Company has produced an average 38 barrels of oil per day and 54 thousand cubic feet per day of natural gas for a total of 43 barrels of oil equivalent per day. Fourth quarter production, after the inclusion of the Clive property, increased to 52 barrels of oil equivalent per day. Revenue for the period was $320,992 with cash flow from Operations of $21,222.

RESERVES

The Company's oil and gas reserves, all located in Canada, were evaluated by NRC Consulting Ltd. effective April 1, 1998.

Total oil reserves net to the Company were 207,311 barrels. Total natural gas reserves net to the Company were 98,820 thousand cubic feet.

COMPANY WORKING INTEREST RESERVES BEFORE ROYALTIES
as at April 1, 1998

	Crude Oil (barrels)	Natural Gas (mcf)	Present Value 15% DCF ($)
Proved			
Producing	114,123	88,880	$ 924,190
Non-Producing	47,899	9,940	$ 281,480
Total Proved	162,022	98,820	$1,205,670
Probable	45,289	0	$ 101,640
Total	207,311	98,820	$1,307,310

AUDITORS' REPORT

To the Shareholders of
Foothills Oil & Gas Ltd.

We have audited the balance sheets of **Foothills Oil & Gas Ltd.** as at December 31, 1997 and 1996 and the statements of loss and deficit and cash flows for the year ended December 31, 1997 and for the six months ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the year ended December 31, 1997 and for the six months ended December 31, 1996 in accordance with generally accepted accounting principles.

Calgary, Canada
May 14, 1998

Chartered Accountants

BALANCE SHEETS
as at December 31

	1997 $	1996 $
ASSETS		
Current		
Cash and cash equivalents	**14,626**	143,400
Accounts receivable	**56,598**	54,702
Inventory, prepaid expenses and deposits	**29,074**	21,850
	100,298	219,952
Property and equipment *(note 3)*	**1,172,627**	716,846
	1,272,925	936,798
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**93,277**	41,925
Long-term debt *(note 4)*	**170,000**	-
Abandonment and site restoration provision	**19,600**	11,600
Deferred income taxes	**-**	27,000
	282,877	80,525
Shareholders' equity		
Share capital *(note 5)*	**1,411,228**	886,228
Deficit	**(421,180)**	(29,955)
	990,048	856,273
	1,272,925	936,798

See accompanying notes.

Approved by the Board

Signed

Signed

STATEMENTS OF LOSS AND DEFICIT

	Year Ended December 31, 1997 $	Six Months Ended December 31, 1996 $
Revenue		
Petroleum and natural gas sales	**320,992**	141,712
Royalties, net of Alberta Royalty Tax Credit	**(28,769)**	(11,605)
	292,223	130,107
Expenses		
Operating expenses	**146,799**	61,338
General and administrative *(note 3)*	**121,027**	45,021
Interest	**10,675**	-
Depletion, depreciation and site restoration *(note 3)*	**422,247**	40,680
	700,748	147,039
Loss from operations	**(408,525)**	(16,932)
Recovery of deferred income taxes *(note 6)*	**17,300**	-
	(391,225)	(16,932)
Deficit, beginning of year	**(29,955)**	(13,023)
Deficit, end of year	**(421,180)**	(29,955)
Loss per share		
Basic and fully diluted *(note 7)*	**(0.04)**	(0.00)

See accompanying notes.

Foothills Oil & Gas Ltd.

STATEMENTS OF CASH FLOWS

	Year Ended December 31, 1997 $	Six Months Ended December 31, 1996 $
Operating		
Net loss for the year	(391,225)	(16,932)
Add items not requiring cash		
Depletion, depreciation and site restoration	422,247	40,680
Deferred income tax	(9,800)	-
Cash flow from operations	21,222	23,748
Changes in non-cash working capital items	42,232	21,938
Cash provided by operating activities	63,454	45,686
Financing		
Issuance of common shares, net of issue costs	517,600	-
Bank loan	170,000	-
Cash provided by financing activities	687,600	-
Net change in non-cash working capital items	-	3,333
	687,600	3,333
Investing		
Expenditures on property and equipment	(879,828)	(63,550)
Cash used in investing activities	(879,828)	(63,550)
Changes in non-cash working capital items	-	(9,311)
	(879,828)	(72,861)
Decrease in cash during the year	(128,774)	(23,842)
Cash and cash equivalents at beginning of year	143,400	167,242
Cash and cash equivalents at end of year	14,626	143,400
Cash flow from operations per share		
Basic and fully diluted *(note 7)*	0.00	0.00

See accompanying notes

NOTES TO FINANCIAL STATEMENTS
December 31, 1997 and 1996

1. BASIS OF PRESENTATION

Foothills Oil & Gas Ltd. (the "Company") was incorporated under the provisions of the Business Corporations Act (Alberta) on September 3, 1993.

Effective December 31, 1996, the financial year-end of the Company was changed from June 30th to December 31st. As such, the financial statements include comparative audited financial statements for the 6 months ended December 31, 1996.

2. SIGNIFICANT ACCOUNTING POLICIES

Property and equipment

Capitalized costs

The Company follows the full cost method of accounting for its petroleum and natural gas properties in accordance with the guideline issued by the Canadian Institute of Chartered Accountants whereby all costs related to the acquisition of, exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized in a Canadian cost centre and charged to income as set out below.

Capitalized costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on non-producing properties, costs of drilling both productive and non-productive wells, equipment costs and general and administrative costs directly related to exploration and development activities.

Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

Depletion and depreciation

Depletion of petroleum and natural gas properties and depreciation of production equipment is provided using the unit-of-production method based on estimated gross proved petroleum and natural gas reserves as determined by independent engineers. Depreciation of production equipment is based on the cost of the assets net of estimated salvage or residual value. The relative amounts of oil and gas production are converted at a ratio of ten thousand cubic feet of gas to one barrel of oil.

Office furniture and fixtures are carried at cost and depreciated over the estimated useful lives of the assets at a rate of 20% calculated on a declining balance basis. Depreciation is charged at half rates in the year of acquisition.

Ceiling test

The Company applies an annual ceiling test to the net carrying value of petroleum and natural gas properties to ensure that such costs do not exceed the estimated amount ultimately recoverable. This amount includes the estimated value of future net revenues from production of proven reserves and the cost of unproved properties, net of an impairment allowance, less future estimated production related general and administrative expenses, financing expenses, estimated future abandonment and site restoration costs and income taxes. Future net revenues are estimated using yearend wellhead prices and costs without escalation or discounting, and the income, capital tax and Alberta royalty tax credit legislation in effect at year end. Any reduction in value, as a result of the ceiling test, is charged to operations.

NOTES TO FINANCIAL STATEMENTS
December 31, 1997 and 1996

Future abandonment and site restoration costs

The estimated cost of future abandonment and site restoration is based on the current costs and the anticipated method and extent of site restoration in accordance with existing legislation and industry practice. The annual charge, provided for on a unit of production basis, is accounted for as an expense. Abandonment and site restoration expenditures are charged to the accumulated provision account as incurred.

Flow-through shares

The Company has financed a portion of its exploration and development activities through the issue of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the Company, the carrying value of the properties acquired and the shares issued are recorded net of the tax benefits renounced to subscribers as the related expenditures are incurred.

Joint operations

Substantially all of the Company's exploration and development activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

Measurement uncertainty

The amounts recorded for depletion and depreciation of property and equipment and the provision for future site restoration costs are based on estimates. The ceiling test calculation is based on estimates of proved reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

Financial instruments

Financial instruments of the Company consist mainly of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and long-term debt. As at December 31, 1997 and 1996, there are no significant differences between the carrying amounts reported on the balance sheet and their estimated fair values.

Inventories

Inventories are stated at the lower of cost or net realizable values. Cost is determined primarily on a first in first out basis.

NOTES TO FINANCIAL STATEMENTS
December 31, 1997 and 1996

3. PROPERTY AND EQUIPMENT

	December 31, 1997			December 31, 1996		
	Cost $	Accumulated depletion and depreciation $	Net book value $	Cost $	Accumulated depletion and depreciation $	Net book value $
Petroleum and natural gas properties and equipment	1,614,447	469,900	1,144,547	754,176	60,700	693,476
Office furniture and fixtures	39,071	10,991	28,080	29,314	5,944	23,370
	1,653,518	480,891	1,172,627	783,490	66,644	716,846

During the year ended December 31, 1997, the Company capitalized general and administrative expenditures of $118,000 (1996 - $62,350) related to exploration, development and acquisition activities.

During the year, the Company reduced the carrying value of petroleum and natural gas properties by $9,800 to recognize the foregone tax benefits to the Company of qualifying exploration and development expenditures incurred and renounced to the purchasers of its flow-through shares.

As at December 31, 1997, petroleum and natural gas properties include $209,800 (1996 - $148,199) relating to unproved properties which have been excluded from the depletion calculation. As a result of the ceiling test calculation, the Company reduced the carrying value of its petroleum and natural gas properties by $310,000 during 1997. This amount is included in depletion expense and accumulated depletion.

4. LONG-TERM DEBT

The Company secured a revolving reducing demand loan facility in the amount of $450,000 which bears interest at the bank's prime rate plus 1.5%. The maximum principal amount available is permanently reduced and repaid by $9,000 per month commencing September 1, 1997. A general assignment of assets and a fixed and floating debenture in the amount of $1,000,000 have been pledged as collateral.

NOTES TO FINANCIAL STATEMENTS
December 31, 1997 and 1996

5. SHARE CAPITAL

Authorized

Unlimited common shares without par value

Unlimited non-voting, first and second preferred shares, issuable in series
The directors of the Company are authorized to determine the designation, rights, privileges, restrictions and conditions attaching to all of the preferred shares.

Common Shares Issued and Outstanding	Number of Shares	$
Balance, June 30, 1996 and December 31, 1996	**9,420,000**	**886,228**
Shares issued pursuant to private placements	2,205,000	547,150
Exercise of stock options	90,000	9,000
Share issue costs	-	(38,550)
Deferred tax	-	7,400
Balance, December 31, 1997	**11,715,000**	**1,411,228**

(a) During 1997, the Company issued 2,205,000 common shares pursuant to private placements at prices of $0.25 and $0.23 per common shares.

(b) During 1997, the Company renounced for income tax purposes, exploration and development expenditures in the aggregate of $240,625. To recognize the foregone tax benefits relating to the renounced expenditures, the carrying values of property and equipment and share capital have been reduced by a total of $9,800 in respect of the incurred expenditures. At December 31, 1997, the Company has $220,000 of remaining expenditures to incur in 1998.

Common Shares Reserved for Employees and Consultants

Under the terms of the Company's stock option plan, 10 per cent of the issued common shares are reserved for issuance. At December 31, 1997, the Company had the following stock options outstanding:

Number of options	Price per option	Expiry Date
685,000	$0.10	March 1, 2001
40,000	$0.14	September 25, 2001
230,000	$0.22	November 26, 2002

Common Shares Held in Escrow

Included in the issued shares are 1,333,333 common shares being held in escrow. One-half of these were released in February 1998 and the remaining will be released in 1999.

NOTES TO FINANCIAL STATEMENTS
December 31, 1997 and 1996

6. INCOME TAXES

The provision for income taxes differs from the calculated tax obtained by applying the combined statutory Canadian federal and provincial tax rate to the income before taxes as follows:

	December 31	
	1997	1996
	$	$
Corporate tax rate	44.34%	44.34%
Pretax loss	(181,140)	(7,500)
Share issue costs	(7,320)	(1,896)
Non-deductible royalties (net)	7,640	373
Resource allowance	(3,110)	-
Depletion in excess of income tax pool deductions	166,630	-
Other	-	9,023
Recovery of deferred tax	(17,300)	-

At December 31, 1997, the Company had exploration and development costs, undepreciated capital costs and unamortized share issue costs available for deduction against future taxable income of approximately $1,200,000. In addition, the Company had approximately $32,000 of non-capital loss carryforwards available for application against income for tax purposes, which expire commencing in 2001, the tax benefits of which are not reflected in the accounts.

7. PER COMMON SHARE AMOUNTS

The calculations of loss and cash flow from operations per share is based on the weighted average number of common shares outstanding during the year ended December 31, 1997 of 10,042,671 (1996 - 9,420,000). The fully diluted weighted average number of shares outstanding during the year ended December 31, 1997 is 10,807,671 (1996 - 10,256,420).

Cash flow from operations per share is based on cash flow from operations before changes in non-cash working capital items.

8. COMMITMENTS

The Company has future operating lease obligations for office premises as follows:

1998 - $21,720
1999 - $21,720
2000 - $21,720
2001 - $ 9,050

9. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year's presentation.

CORPORATE INFORMATION

DIRECTORS

Kevin A. Kelly
Managing Director
RBC Dominion Securities (Global) Limited
Nassau, Bahamas

William J. Kiff
President of the Company
Calgary, Alberta

Susan J. McArthur
President, McArthur & Associates
Toronto, Ontario

Raymond A. Siwiec
President, First Canadian Energy Ltd.
Calgary, Alberta

OFFICE

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AUDITORS

Barr Shelley Stuart
Calgary, Alberta

OFFICERS

William J. Kiff
President

Charles W. Berard
Corporate Secretary

Wayne D. Fast
Vice President

SOLICITORS

Macleod Dixon
Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

Montreal Trust Company of Canada
Calgary, Alberta

STOCK EXCHANGE LISTING

The Alberta Stock Exchange
Symbol: FH

Abbreviations

bbl	barrels
boe	barrels of oil equivalent
mcf	thousands of cubic feet
ARTC	Alberta Royalty Tax Credit